

# **TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0571**

"Title to Gas in LNG facilities"

Version 1.0

**Date:** 24/07/2002

**Proposed Implementation Date:** 01/09/2002

**Urgency:** Non-Urgent

## **Justification**

A number of gas storage users have expressed the desire to hold Title to Gas in gas storage facilities. The principal drive is concern over potential loss of the value of gas in store. For example there might be a fear that should the storage operator's parent company get into financial difficulties it could choose to sell gas held in store. This could threaten the operator's ability, in full or part, to meet contractual obligations to make gas available for withdrawal.

Although this is not regarded as a high immediate risk in respect of Transco and Transco LNG Storage (TLNGS) the proposed separation between them, and the sale last year of BG Storage Ltd by its owner shortly after a similar separation, means that shippers should recognise there might be a future change in the ownership of TLNGS and its storage facilities which might cause higher levels of risk to emerge.

The main concerns would be substantially assuaged if Storage Users were able to take title to their gas-in-storage.

Changes to the contractual relationships with TLNGS can at present be pursued by means of a Code Modification, a route which is likely to be closed as a result of the proposed separation. Hence it is timely to advance this Modification quickly.

It is also timely as a number of storage users are seeking title to gas in storage facilities owned by another major storage operator, and it would be unseemly to pursue such a change with one such operator without simultaneously proposing a parallel change in respect of TLNGS.

In addition it is considered important that the storage operator operates the storage facility in such a way so as not to prejudice their ability to meet shippers' withdrawal nominations. This entails maintaining adequate levels of cushion gas in storage facilities. Thus this Modification also proposes that additional information be made available to the shipping community concerning title to gas in store.

The proposed changes may be seen as a "win-win" situation, with benefits both for TLNGS and storage users. The benefit for storage users is the removal of any doubts or concerns they may have, including relating to any change in the ownership of TLNGS, for whatever reason. The proposed changes may well benefit the Storage Operator by enhancing the value of the service provided as perceived by existing and potential customers, thereby improving (or at least avoiding any deterioration in) the prices that the services on offer are likely to command. On the other hand, the absence of such changes could be seen as likely to reduce the underlying value of the storage facilities as assets.

## **Nature of Proposal**

It is considered that this Proposal raises issues in eight key areas.

### **1 Definition of Title**

In principle, it is proposed that for the purposes of holding title to gas in store the gas in a storage facility at any time is divided into three components, as follows -

- i) storage Users' gas, defined for each User at any time by that User's "gas-in-storage" providing this is not negative
- ii) a share of the remainder deemed to be gas being held to the storage manager's account
- iii) all other gas in store at any time

Storage Users would then be permitted to hold title to a quantity of gas which equals their gas-in-storage at any time providing this quantity is not negative.

In principle, this can be achieved by fairly simple changes to Code Section Z1.6, as illustrated in the Annex to this Proposal, but the concept of title to a proportion of the gas in a storage facility introduces a number of additional issues, not all requiring Code changes in the case of TLNGS' facilities.

Any subdivision of title to the gas in store not "owned" by Users would be at the discretion of the storage facility owner(s), but it is strongly recommended that sufficient of this gas should be nominally "held" by the storage manager to allow for operating uncertainties. For example, Users' nominations are generally held whole (at present at least) at LNG Facilities, and to allow cost-effective operations TLNGS are only required to accept or provide the requisite amounts of gas at the NBP and to adjust each User's gas-in-storage appropriately.

TLNGS are however entitled, for example, to bundle the various nominations and can determine to manage their operations differently if in their judgement this is likely to prove economic. For example, (subject of course to physical limitations) TLNGS would be entitled to choose to inject or withdraw all the gas presented to them on a day into and out of one site instead of into or out of the sites to which the nominations refer. The original Code concept of the Storage Manager was designed to allow a Storage Operator to make use of this flexibility by maintaining a "balancing account" at any storage facility, in three main cases -

- to enable the Operator to add to or reduce their own inventory when they choose to redirect a physical withdrawal or injection to a different site
- to trade to alter the total gas injected or withdrawn on a Day
- to hold Users' nominations whole when the metered flows are different, by "accepting" all net differences.

Hence it is envisaged that the storage operator may, to this end, "own" some of the gas in a storage facility at any stage.

It is in the interests of the Users that apart from their own gas in store there is sufficient in store to facilitate normal operations. For the purposes of this proposal such gas can be regarded as "cushion gas", required to ensure that pressures or physical quantities do not fall below safe operating limits or levels required to enable Users' overall gas-in-storage to be withdrawn at rates (and notice periods) to meet their contractual entitlements.

The storage operator would naturally be the logical owner of gas needed to offset boil-off from LNG facilities. His account would reduce as such gas is exported, and he would (as now) buy additional gas occasionally to replace the boil-off so as to ensure LNG Users' gas can be "held whole".

It is not necessarily desirable from the facility owner's viewpoint for all the "cushion" gas to be regarded as accessible for "operating flexibility". For example, some of the "cushion gas" may be recoverable in due course but only after "normal" storage operations cease or are scaled down: such gas is potentially an asset whose value can be realised in the short term by (for example) being used as collateral for loans. It would not be in storage Users' interests to hinder such funding provided it does not jeopardise

"normal" storage operations. Hence it is proposed that the gas in store not "belonging" to Users and not needed for short-term flexibility/operations is capable (at the owner's choice) of being separated for title purposes.

This permits "flexibility" in operations as at present, without jeopardising storage Users' holdings or the owner's interests.

From time to time the quantity of cushion/native gas in a reservoir (or other storage facility) is reviewed. The above "three-part" model admits this. In effect any redetermination alters the quantity of gas in store "owned" by the facility owner and any investors, and the model proposed reflects this by any adjustments falling to the owners' holding or (if the owner prefers) the storage manager's allocation.

## **2 Title of Gas at Entry/Exit to/from Transco's System**

The Network Code assumes that Title will move between Transco and the storage operator at the point of entry and exit. To this end, Title to gas being injected into store should pass at System exit to the storage operator and then (where injected to increase a storage User's gas-in-storage) to the storage User, and Title to gas being withdrawn from store should pass from the storage User to the storage operator so that at the point of entry to Transco's System the Title moves from the storage operator to Transco.

A possible outline is indicated in the Annex to this note in respect of proposed paragraph Z1.6.4.

## **3 Transco Emergencies**

Storage operators can be required to provide gas for the System in the event of an Emergency without needing to advise Users of any allocation between Users of the withdrawal and without needing Users' agreement.

It does not appear that any additional specific Code changes would be needed. Essentially TLNGS would withdraw gas and provide an allocation as if Users had authorised a withdrawal. As with any withdrawal, title would move first from the storage User to TLNGS and instantly from TLNGS to Transco.

## **4 Negative Gas-in-Store**

Though title should be based on the defined "Gas-in-Storage" quantities, it is possible for these quantities to become negative. One example would be if a User has a series of trades for a day which would leave gas-in-storage positive but one of the "receiving" trades becomes cancelled.

Negative gas-in-storage then triggers over-run payments, and if not corrected can lead to termination.

The relevant rules should be left unaltered, but it is necessary for a storage User to be entitled to hold Title to a quantity defined at any time as their "gas-in-storage" (defined in paragraph Z1.3.1) providing this quantity is positive, or zero if that quantity is negative.

## **5 User Termination**

In the event that a Storage User is terminated, the Title to any gas-in-storage held by that User should immediately revert to the storage operator, ie TLNGS in this case.

This permits the release of the User's capacity and gas-in-storage as happened with Enron's Rough capacity and gas when Enron "failed" in late 2001.

This can be achieved by an extension to paragraph 10.1.2 so that *"Upon a User's ceasing to be a User for the purposes of this Section Z.... Transco LNG Storage shall take Title to any gas-in-storage to which the User holds Title under paragraph 1.6"*

## **6 Option to Take Title or Not**

The Code should allow the storage User to take Title to Gas but also leave them the option of retaining the existing contractual structure. This is illustrated in the Annex in respect of the draft paragraph Z1.6.3 -

*"The User shall be entitled to have Title to a quantity of Gas contained in a Transco LNG Storage Facility equal at any time to that User's gas-in-storage, provided that gas-in-storage is not negative. .... The User will advise Transco LNG Storage if he wishes to hold Title to his gas-in-storage in this manner. If the User so elects, his election may not be cancelled other than with the approval of Transco LNG Storage. If the User elects not to hold Title in this manner or does not advise Transco LNG Storage of his wishes then Transco LNG Storage shall have Title to and risk in the User's gas-in-storage."*

This element of choice is essential if prompt benefit is to be available to those Users who desire to hold title to "their" gas, without requiring any Users to hold Title if they do not so wish. This gives the choice of the proposed changes (or enhancements) or to retain the existing arrangements.

## **7 Risk**

This Proposal would allow Users to hold Title to "their" gas-in-storage but would leave "risk" as at present with TLNGS.

Essentially at present TLNGS "bear the risks", and the value of this is factored into the prices paid for the services. An area of potential significance is third-party risk, including risk to Transco's systems.

An alternative would be to offer title "with risk". This is simply much more complex, as it would involve "partitioning" any risk exposure.

Also, some storage Users might conclude that the disadvantages of the transfer of risk are sufficiently material that they should not accept "title and risk", and it might be considered discriminatory and hence unacceptable for some storage Users to have "title but no risk" and others to have "title and risk" without some "financial adjustment".

This may mean that the benefits (to storage Users and the TLNGS) of allowing storage Users to take title would be lost.

As transferring risk can be seen as devaluing the contract's value, it can be argued that the value of risk being held by TLNGS is already covered by part of the prices offered at auction and paid for late bookings, and that there is no convincing case for altering the "status quo".

## **8 Monitoring Information**

Holding "title" to gas in store may not fully assuage concerns unless this is supported by assurance that sufficient gas actually exists in each store to enable that store to meet the requirements of the collective bookings.

Each customer can check their inventory via CALMS, but to have sufficient security and confidence there needs to be a composite list of total ownership of gas in store subdivided between the users and the storage facility operator. The distribution of ownership of the gas will at any stage be commercially confidential. It would therefore be wholly inappropriate for a full tabulation of such ownership to be published or accessible by all interested parties. Yet each interested party should have means of

ensuring their particular interests and rights are not in any way in jeopardy, or the comfort of third-party checks that sufficient gas is accessible for all valid interests to be protected.

It is therefore proposed that CALMS should be adapted to show overall gas-in-store ownership for each LNG Facility subdivided merely between LNG Users (in total) and others holding title to gas (also in total).

The intent is to demonstrate that, in addition to the necessary cushion gas, sufficient gas is in store to enable the users' withdrawal entitlements to be met. This would therefore need to be supported by an indication of the minimum inventory needed in each Facility to enable five consecutive days' withdrawal at the Facility's Total Storage Deliverability. It is proposed that this additional information be provided each year in TLNGS' Annual Storage Invitation.

The additional information envisaged in TLNGS' Annual Storage Invitation would require an additional clause in Code paragraph Z3.1.3. The change to CALMS appears not to be a "Code change"

## **Purpose of Proposal**

Detailed within "Nature of Proposal"

## **Consequence of not making this change**

Users of LNG Services may find themselves exposed to future risk which is less easily addressed than by a Code Modification prior to separation of TLNGS from Transco.

After separation, such a change might require all LNG Users to agree to a common contract change, albeit one which could offer each LNG User the option to hold Title to their gas-in-storage or the option to leave Title with TLNGS.

## **Area of Network Code Concerned**

Section Z

### **Annex**

#### **Summary of Possible Changes to Code Section Z to allow Storage Users to hold Title to Gas in Store**

*Italicised text comprises proposals; non-italicised text is as in Code at present*

### **Section Z:1.6 - Title and Risk to Gas**

Existing Text -

1.6.1 Transco LNG Storage shall have title to and risk in all gas contained in any Transco LNG Storage Facility

1.6.2 Title and risk to gas injected by a User to or withdrawn by a User from a Transco LNG Storage Facility shall be treated as passing from the User to Transco LNG Storage or (as the case may be) from Transco LNG Storage to the User at the same point and at the same time at which title thereto passes from Transco to the User or (as the case may be) from the User to Transco.

Suggested Revision -

1.6.1 Transco LNG Storage shall have title to and risk in all gas contained in any Transco LNG Storage Facility, except where a User elects to hold title to his gas-in-storage as permitted by paragraph 1.6.3

1.6.2 Title and risk to gas injected by a User to or withdrawn by a User from a Transco LNG Storage Facility shall be treated as passing from the User to Transco LNG Storage or (as the case may be) from Transco LNG Storage to the User at the same point and at the same time at which title thereto passes from Transco to the User or (as the case may be) from the User to Transco.

1.6.3 The User shall be entitled to have Title to a quantity of Gas contained in a Transco LNG Storage Facility equal at any time to that User's gas-in-storage, provided that gas-in-storage is not negative. To this end:

a) the User agrees to accept Title each Day to gas added to his gas-in-storage under paragraphs Z1.3.1(a)(i) and (ii) and Transco LNG Storage agrees to transfer Title to the User for this quantity of gas, and

b) the User agrees that Transco LNG Storage shall take Title each Day to gas taken from his gas-in-storage under paragraph Z1.3.1(b) and Transco LNG Storage agrees to take Title to this quantity of gas.

The User will advise Transco LNG Storage if he wishes to hold title to his gas-in-storage in this manner. If the User so elects, his election may not be cancelled other than with the approval of Transco LNG Storage. If the User elects not to hold Title in this manner or does not advise Transco LNG Storage of his wishes then Transco LNG Storage shall have Title to and risk in the User's gas-in-storage.

1.6.4 Title to Gas injected by the User into, or withdrawn by the User from, a Transco LNG Storage Facility shall be treated as passing from Transco LNG Storage to the User (or as the case may be) from the User to Transco LNG Storage at the Storage Connection Point and at the same time at which title passes from Transco (or as the case may be) to Transco.

## **Section Z:10.1 - Storage Termination - General**

Existing Text -

10.1.2 Upon a User's ceasing to be a User for the purposes of this Section Z in accordance with paragraph 10.1.1 subject to paragraph 10.3.5, this Section Z shall cease to bind the Discontinuing Storage User and (as respects the Discontinuing Storage User) Transco LNG Storage.

Suggested Revision –

10.1.2 Upon a User's ceasing to be a User for the purposes of this Section Z in accordance with paragraph 10.1.1 subject to paragraph 10.3.5, this Section Z shall cease to bind the Discontinuing Storage User and (as respects the Discontinuing Storage User) Transco LNG Storage and Transco LNG Storage shall take Title to any gas-in-storage to which the User holds Title under paragraph 1.6

## **Section Z:3.1 - Annual Storage Invitation**

Suggested Addition to Existing Text -

3.1.3 Transco LNG Storage's invitation (the "Annual Storage Invitation") under paragraph 3.1.1 will specify in respect of each Transco LNG Storage Facility:

.....

(k) An estimate of the minimum quantity of gas needed in each facility to enable five consecutive days' withdrawal at the Facility's Total Storage Deliverability.

(l) Such other matters as may be provided for in this Section Z or, not being inconsistent with any provision of this Section Z, as Transco LNG Storage may reasonably determine.

[Clause (l) above is the present Clause (k); clause (k) above is new]

tw/16.7.02

**Proposer's Representative**

Mike Young (BG Trading)

**Proposer**

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**Signature**

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